

Office of Chief Counsel
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Memorandum

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date:

February 8, 2007

to: Associate Area Counsel -
(Small Business/Self-Employed)

Attn:

from:

Branch Chief, Branch 3
(Income Tax & Accounting)

subject:

LEGEND

State A =

Statute A

B Tax Relief =

Law B

X =

Y =

Q =

R =

This memorandum responds to your request for assistance regarding the proper federal income tax treatment of a payment made under Statute A under §§ 61, 111, 164 and 6041 of the Internal Revenue Code. This advice may not be used or cited as precedent.

ISSUES

(1) What is the proper federal income tax treatment of payments made to residents of State A under the property tax rebate program authorized by Statute A (the “B Tax Relief” property tax rebate)?

(2) Is State A required to report such payments under § 6041 or § 6050E of the Internal Revenue Code?

CONCLUSIONS

(1) A taxpayer who receives a B Tax Relief property tax rebate of real property taxes in the same tax year the real property taxes were paid is not required to include the rebate in gross income in the year received, except to the extent, if any, that it exceeds the real property tax paid by the taxpayer. The amount of the rebate, however, reduces the taxpayer's real property tax deduction for federal income tax purposes. A taxpayer who receives a B Tax Relief property tax rebate of real property taxes previously deducted on a prior year's federal income tax return must include the rebate in gross income in the year received to the extent of any federal income tax benefit, and to the extent, if any, that it exceeds the real property tax paid by the taxpayer.

(2) State A is not required to report such payments under § 6041 or § 6050E of the Internal Revenue Code.

FACTS

Statute A provides that a local property tax rebate (“B Tax Relief rebate”) shall be provided to the owner of any parcel of property which is entitled to the basic or enhanced B Tax Relief exemption (a State A tax relief program) on their primary residences. Under Law B, a parcel is entitled to the basic or enhanced B Tax Relief exemption if it is a one, two or three family residence, a farm dwelling or residential property held in condominium or cooperative form of ownership and if it serves as the primary residence of one or more of the owners of the property.

Statute A further provides that generally the amount of the rebate shall be equal to \$X (\$Y in the case of certain eligible tenant-shareholders) multiplied by the product of

the school district tax rate and the sales price differential factor for the district. The rebate amount for qualified senior citizen taxpayers is additionally multiplied by a factor of Q. An individual is not entitled to receive the B Tax Relief rebate if the individual owes property taxes relating to a prior tax year. The rebate amount, if not paid because of delinquency, is not applied against the unpaid real property tax liability.

Real property taxes in State A are assessed by and paid to local government entities, which also determine when the property tax is to be paid. Generally it is paid in September, although some localities require the property tax to be paid quarterly. Most B Tax Relief rebate payments were made in 2006 by the State A Department of Taxation and Finance, however, some B Tax Relief rebate payments will be made in 2007. (We note that the real property tax is imposed by local government entities and the rebate is paid by the State A Department of Taxation and Finance. State A delegates the authority for the levy, collection and administration of local taxes authorized by the legislature to local governments. Based upon the provisions of R, we conclude that State A has a degree of control over the localities and a financial commitment to them such that the localities are an integral part of State A. State A is not a third party to the payment of the tax because it is indistinguishable from the localities.)

Persons receiving the B Tax Relief rebate generally file their federal income tax returns on a calendar year basis using the cash receipts and disbursements method of accounting and may either claim the standard deduction or claim itemized deductions for real property taxes.

LAW AND ANALYSIS

Section 61(a) provides that, except as otherwise provided in subtitle A, gross income means all income from whatever source derived. See also §1.61-1(a) of the Income Tax Regulations. Gross income is an undeniable accession to wealth, clearly realized, over which a taxpayer has complete dominion. Commissioner v. Glenshaw Glass Co., 348 U.S. 426 (1955), 1955-1 C.B. 207.

The rebate to a taxpayer of an amount paid for the purchase of property is not an accession to wealth because the rebate is in the nature of a reduction in the purchase price. See Rev. Rul. 76-96, 1976-1 C.B. 23. Likewise, the refund to a taxpayer of an amount overpaid in satisfaction of a liability is not an accession to wealth. See Rev. Rul. 79-315, 1979-2 C.B. 27.

Section 164 of the Code provides, in part, the general rule that, except as otherwise provided in § 164, state and local real property taxes shall be allowed as a deduction for the taxable year within which paid or accrued.

Rev. Rul. 78-194, 1978-1 C.B. 24, discusses the treatment of a homestead tax rebate enacted by the New Jersey legislature. The amount of that rebate was based on the equalized value of the dwelling house and was intended to be a return of property

tax due and payable on the residence in 1977. The ruling held that the homestead tax rebate for property tax due and payable on the dwelling house for 1977 was includible in the gross income of the taxpayer only to the extent it exceeded the property tax for the dwelling house actually paid by the taxpayer in 1977 and that, for a taxpayer who itemized deductions, the deduction for property tax paid on the residence must be reduced by the amount of the rebate.

Section 111(a) provides that gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by chapter 1 of subtitle A of the Code.

In Hillsboro National Bank v. Commissioner, 460 U.S. 370 (1983), 1983-1 C.B. 50, the Supreme Court discussed the tax benefit rule. The tax benefit rule is a judicially developed principle that modifies the annual accounting doctrine under certain circumstances. The basic purpose of the tax benefit rule is to achieve rough transactional parity in tax and to protect the Government and the taxpayer from the adverse effects of reporting a transaction on the basis of assumptions that an event in a subsequent year proves to have been erroneous. Id. at 383. The tax benefit rule will “cancel out” an earlier deduction when the later event is fundamentally inconsistent with the premise on which the deduction was initially based. Id.

In general, a taxpayer who receives a rebate of state taxes previously deducted on a prior year’s federal income tax return must include the rebate in gross income in the year received to the extent of any federal income tax benefit, unless all or part of the income is excluded under § 111. A taxpayer who receives a rebate of state taxes that were not previously deducted on a prior year’s federal income tax return is not required to include the rebate in gross income in the year received. See Rev. Rul. 93-75, 1993-2 C.B. 63. Cf. Rev. Rul. 79-315, 1979-2 C.B. 27; Rev. Rul. 70-86, 1970-1 C.B. 23. In either case, however, a taxpayer must include the rebate of state taxes in gross income to the extent that it exceeds property taxes actually paid by the taxpayer. See, e.g., Rev. Rul. 78-194, 1978-1 C.B. 24.

Like the rebate discussed in Rev. Rul. 78-194, the B Tax Relief rebate is determined by the application of a formula that is indirectly based upon the homeowner’s real property tax and is intended to be a return of property tax paid on the residence. Therefore, in accordance with the rulings cited above, a taxpayer who receives a B Tax Relief property tax rebate of real property taxes in the same tax year the real property taxes were paid is not required to include the rebate in gross income in the year received, except to the extent that it exceeds the real property tax paid by the taxpayer. The amount of the rebate, however, reduces the taxpayer’s real property tax deduction for federal income tax purposes. A taxpayer who receives a B Tax Relief property tax rebate of real property taxes previously deducted on a prior year’s federal income tax return must include the rebate in gross income in the year received to the extent of any federal income tax benefit, and to the extent that it exceeds the real property tax paid by the taxpayer.

We note that, under certain circumstances, a taxpayer's itemized deductions, including a deduction for real property taxes, may be reduced in accordance with the overall limitation on itemized deductions under § 68(a). Rev. Rul. 93-75, 1993-2 C.B. 63, provides guidance on the application of the tax benefit rule in situations in which a taxpayer's itemized deductions in a prior taxable year were reduced by the limitation in § 68(a) and the taxpayer subsequently recovers all or a portion of the previously deducted amount.

Reporting requirements under section 6041 or 6050

Section 6041(a) provides, in part, that all persons engaged in a trade or business and making payments in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more in any taxable year shall render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

Section 1.6041-1(c) of the Income Tax Regulations provides that income is "fixed" when it is to be paid in amounts definitely predetermined. Income is "determinable" when there is a basis of calculation by which the amount may be ascertained.

As used in § 6041, the term "gains, profits, and income" means gross income and not gross amounts paid. A payor is generally not required to make a return under § 6041 for payments that are not includible in the recipient's income, and a payor is not required to make a return if the payor does not have a basis to determine the amount of a payment that is required to be included in the recipient's gross income. State A does not have a basis to determine the amount of a payment that is required to be included in the recipient's gross income. Therefore State A is not required to report the B Tax Relief rebate payments under section 6041.

Section 6050E provides that every person who, with respect to any individual, during any calendar year makes payments of refunds of State or local income taxes (or allows credit or offsets with respect to such taxes) aggregating \$10 or more shall make a return according to forms or regulations prescribed by the Secretary setting forth the aggregate amount of such payments, credits, or offsets, and the name and address of the individual with respect to whom such payment, credit, or offset was made.

Section 6050E only requires reporting of refunds of income taxes and not of property taxes. The information provided indicates that the B Tax Relief rebates made by State A are property tax refunds and not income tax refunds and therefore State A is not required to report the refund of the property tax under § 6050E.

Please call 622-4950 if you have any further questions.